IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 755

MUNICIPAL INVESTORS ASSOCIATION,
Plaintiff and Appellant,
vs.
CITY OF BIRMINGHAM,
Defendant and Appellee

BRIEF OF AMICUS CURIAE IN SUPPORT OF APPELLANT'S ARGUMENT FOR REVERSAL

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Consent of appellants and appellees to the filing of this brief has been given pursuant to Rule 27, Section 9.

Our purpose is to emphasize several reasons on which we believe the case ought to be reversed. We have no interest in the issue of bonds referred to in the pleadings in this suit, but in behalf of clients who hold bonds of many other Michigan special assessment districts, desire

to have a principle established which will prevent their virtual repudiation through withdrawal of the taxing power which supports them. The clients whom we represent have a large amount of capital in municipal bonds generally, whose value will be adversely affected if legislation such as that under consideration in this case is not held to impair contract obligations.

For the purpose of this argument, we assume that the court will hold that it has jurisdiction and that it must examine the legislation in question as it has been interpreted by the lower court, and decide whether it contravenes Article I, Section 10, of the United States Constitution.

ARGUMENT

We adopt the summary of argument contained on page 14 of appellants' brief. We advance the following points.

I. Impairment of contract rights is a power reserved only to the federal government through the grant of power to enact bankruptcy laws.

II. Even though the states possess certain reserved sovereign powers to prescribe remedies for the enforcement of contract obligations, such powers must be exercised in such manner as not to violate the federal constitution.

III. Any device adopted by a state government, the purpose and effect of which is to materially diminish the means of enforcing payment of debts, is an impairment of contract.

IV. The state legislation in question here, as construed by the Michigan Supreme Court, does materially diminish the means afforded municipal creditors to enforce payment of their obligations.

POINT I

IMPAIRMENT OF CONTRACT RIGHTS IS A POWER RESERVED ONLY TO THE FEDERAL GOVERNMENT THROUGH THE GRANT OF POWER TO ENACT BANKRUPTCY LAWS

Enough is known of the reasons which actuated the constitutional convention to incorporate Article I, Section 10, to enable us to properly interpret it. The opinions in *Home Building & Loan Assn. v. Blaisdell*, 290 U. S. 398, collect the various historical material which shows the conditions prevalent at the time which must have operated upon the minds of the framers of the constitution. One of the potent causes leading to disunity and conflict between the states was a practice of enacting state laws which impaired contract rights. Not only did such laws produce a condition of economic stagnation, but as they were often passed for the purpose of discrimination against creditors of neighboring states, they induced retaliatory legislation in those states, destroyed interstate commerce, and could ultimately lead to more serious conflict.

Inasmuch as the framers of the constitution did not prohibit the Congress from enacting laws impairing contract obligations, but specifically authorized it to enact bankruptcy legislation, which embraces every form of contract impairment, we must conclude that the framers of the constitution recognized that the police power residing in government might require such laws, but that the only safe agency to make them was the national government.

We now have laws passed by Congress which permit state agencies and taxing districts to invoke the bankruptcy power under such conditions as Congress deems expedient. Amendment to Bankruptcy Act, enacted August 16, 1937, 50 Stat. 751, 28 U. S. C. A., Sections 401-404,

Cf. *U. S. v. Bekins,* 304 U. S. 27. An attempt by the states to legislate taxing districts and municipalities out of their debts is nothing less than an exercise of bankruptcy powers, a field of governmental power exclusively reserved to Congress.

When we consider appeals in behalf of such legislation as is here involved, on the ground of necessity and the assertion that government must have power to provide social and economic conditions which make orderly government possible, the answer is obvious. Government does possess such power. Those who believe that debts of a certain nature have become so oppressive as to require extinction or diminution can appeal to a legislative body, where such laws can be obtained. The supreme law of the land, the federal constitution, directs that such legislation must be obtained from Congress, not from state legislatures.

It is just as incongruous to think of states possessing power to impair contracts, because the state legislature deems it necessary to exercise such power in order that government may be preserved, as to think of states exercising the power to coin money, make war or peace, etc. Judgment as to what is necessary, appropriate or desirable in all these fields of legislation is denied to them. No one would suppose that a state legislature, deeming it expedient and for the benefit of its people that it make a treaty of peace with Japan, could exercise this power. It is just as contrary to our form of government, with division of powers between the states and national government, to permit states to legislate creditors out of their rights because it is the judgment of the state law making body that its interests so require.

POINT II

EVEN THOUGH THE STATES POSSESS CERTAIN RESERVE POWERS TO PRESCRIBE REMEDIES FOR THE ENFORCEMENT OF CONTRACT OBLIGATIONS, SUCH POWERS MUST BE EXERCISED IN A MANNER NOT TO VIOLATE THE FEDERAL CONSTITUTION

It is perfectly clear, as the many cases decided in connection with Article I, Section 10, have held, that power to prescribe remedies is limited by this clause. A state may not remove all remedies, leaving nothing in their place, so that all that remains to the creditor is the naked satisfaction that the debtor ought to pay him. It cannot put so many obstacles in the way of enforcement as to make the right valueless.

Appellees contend that holders of bonds, even after this legislation, possessed a remedy. They might have bid in the property. This scarcely can be considered a right for which the creditors bargained—a right common to the whole world to attend a sale for delinquent taxes and bid on the property. The bonds were sold under an arrangement which gave the holder the right to a continued exercise of the taxing power to provide funds for their payment. When this was removed, no remedy at all was left.

POINT III

ANY DEVICE ADOPTED BY A STATE, THE PURPOSE AND EFFECT OF WHICH IS TO MATERIALLY DIMINISH THE MEANS OF ENFORCING PAYMENTS OF DEBTS, IS AN IMPAIRMENT OF CONTRACT

One would hardly expect a state legislature, intent upon violating the contract clause of the constitution, to do so in a clumsy, direct manner. Such a purpose would always be concealed as far as possible under some cloak of legitimate state action. The court, in enforcing the constitution, must look beneath the surface and refuse to be misled by the form adopted.

As this legislation is construed, an attempt is made to give it a plausible character through the operation of a deed to be given by a state agency. By reason of that, appellees contend that this is not a direct impairment of contract rights—the state is merely exercising a right of disposing of its own property, acquired through a tax foreclosure sale, on such terms as it sees fit. One of the terms which it has seen fit to include in the deed is the grant of an exemption to the property from all debt service taxes, which may be levied in the future, to meet pre-existing debts incurred in behalf of taxing districts. Appellees argue that this puts a different light upon the situation than if the state merely enacted legislation saying that land delinquent for a given number of years for taxes should henceforth be exempt from taxes to meet pre-existing debts. We submit that there is no difference. The procedure of holding an auction sale and issuing a deed or contract to the highest bidder does not permit the grant of this immunity. The state may, of course, fix the terms of payment, the price, and security exacted for deferred payments, as those matters pertain to the disposition of property owned in its proprietary capacity.

When, however, it attempts to grant an exemption to such land from future taxes of a specified character, it is acting in its governmental capacity. Action in a governmental capacity, if contrary to rights guaranteed by Article I, Section 10, must be restrained.

Although appellees' brief does not suggest it, the following question may be raised. Since states have power to define what lands may be exempt from taxes, may they not expand the grounds of exemption after bonds have been issued? We think that question must be answered in the negative, when it appears that the expansion is of such a degree that it necessarily must result in destroying the taxing power of the municipality pledged to the payment of the debt. No case in this court has directly passed upon this point, but state and lower federal courts have encountered the question and held that an extensive newly created exempt class of property remains taxable for the purpose of raising funds to discharge pre-existing public debts. The Florida constitution was amended in 1934 to provide that homesteads up to $5000.00 should be exempt from all taxation, except for special assessments. Previous to that, the only exempt property was that used for municipal, educational, literary, scientific, religious or charitable purposes. Much litigation followed this constitutional amendment to determine whether homesteads should be included in debt service levies to provide payment for bonds outstanding when the constitutional amendment was adopted. The courts in which the question was presented all held that they must be included, since the state constitutional amendment could not impair rights of bondholders to the collection of such taxes as the municipalities were entitled to levy at the time the bonds were issued. We content ourselves with citing the last of some nine decisions of the Florida Supreme Court, *Long v. St. Johns,* 126 Fla. 1, 170

So. 317, 109 A. L. R. 522, which, in turn, cites prior decisions all to the same effect, and *Groves v. Board of Education,* 109 Fed. (2) 522. These all rest on the exclusive ground that the obligations of the contract of the bondholder are impaired by subsequent state action removing homesteads as a source of taxation for bond payments. If this court should hold that this Michigan legislation does not impair contract rights, millions of dollars of outstanding Florida bonds will be jeopardized, for the Florida situation cannot be distinguished. Few Florida municipalities could meet bond obligations incurred prior to 1934 if homesteads were exempt from debt service taxes. The Florida courts would have to overrule their decisions as a result of any decision by this court that the Michigan bondholders under like circumstances have not suffered an impairment.

In two early state court cases, *State, Hall Prosecutor v. Parker,* 33 N. J. L. 312, and *Bailey v. Sutch,* 6 Phila. (Pa.) 408, the courts declined to hold that an increase in exemptions impaired bond obligations, but placed their decisions on the ground that they were so trifling as not to affect contract rights, other sources of revenue being ample to pay the bonds. In *Arkansas S. R. Co. v. Louisiana & A. R. Co.,* 218 U. S. 431, this court declined to hold that a change in exemptions operated to violate contract rights. That case was considered by the Florida Supreme Court in *Long v. St. Johns, supra,* and distinguished on grounds, which we think quite pertinent, that the complaining party was not a creditor. It had merely been voted a bonus of 5 mills on all taxable property within a parish. Furthermore, this court showed by its opinion that it recognized that cases might arise where a subsequent increase in exemptions might not be countenanced. It said:

> "An authority given by the state to promise and levy a tax for future years on the taxable property

> in the parish does not purport to limit the power to say what property shall be taxable when the time comes—at least, by general regulations not aimed at aiding an evasion of the promise it has allowed."

We think this a case where the increase in exemptions is aimed at aiding an evasion of the promise which the State of Michigan has allowed the Village of Birmingham to make. In Michigan, as in Florida, the law at the time these bonds were issued defined what real property should be exempt from taxes. Section 3395, Michigan Compiled Laws 1929, named certain classes of property which should be exempt from taxation, which roughly corresponded to the classes defined in Florida. Nothing in the classification there given could be construed to include property which had been acquired by the state and sold to private owners.

If it is decided that this Michigan legislation does not impair creditor rights, then is not every bond issued by a municipal corporation, whether a general obligation of the issuing body or a limited obligation, as these Birmingham bonds, held subject to legislative power to make sweeping extensions of areas of exempt property, thus reducing the areas subject to debt service taxes so greatly that they cannot possibly support taxes necessary to pay the bonds?

It must be recognized that in the development of municipalities, some properties will become exempt and creditors must take their chance that this may happen. The state might sell some of these lots to the national government for a postoffice, for instance, which then would not be subject to an additional levy. However, the creditor can rely, or at least ought to be able to rely, on the fact that there will be no expansion by legislation of the classes of exempt property, which will have the effect of classifying practically all the property in the district or municipality as exempt from meeting tax burdens for the payment of his bonds.

POINT IV

THE STATE LEGISLATION IN QUESTION HERE, AS CONSTRUED BY THE STATE SUPREME COURT, DOES MATERIALLY DIMINISH THE MEANS AFFORDED MUNICIPAL CREDITORS TO ENFORCE PAYMENT OF THEIR OBLIGATIONS

This case illustrates a condition typical of many others. Many bonds are outstanding whose payment can only be enforced through an exercise of power to levy additional assessments on lands in a special assessment district. The bonds carry no general obligation of a municipal corporation to pay. All that the corporation or some officer or board was obliged to do was to levy and enforce original assessments, and if those could not be collected, additional assessments. In many of these districts in Michigan, taxpayers either wilfully, or by reason of inability, failed to pay general and special taxes. These properties passed to the state, but are again in private hands or soon will be. The properties upon which the owners paid their taxes constitute but a small area in the assessment district, and if the creditor is obliged to resort to these alone, the debt cannot be paid.

Counsel for appellees, on page 14 of their brief, point to language used in *Worthen Co. v. Kavanaugh*, 295 U. S. 56, *i. e.*

> "A catalogue of the changes imposed upon the mortgage must lead to the conviction that the framers of the amendments have put restraint aside. With studied indifference to the interests of the mortgagee or to his appropriate protection, they have taken from the mortgage the quality of an acceptable investment for a rational investor."

They say that a different spirit actuated the passage of this legislation. We believe that as the statute was passed

and signed by the governor, the legislature did not intend that it should have the sweeping effect which judicial interpretation has given it, but that question is not now open. It must be regarded now as meaning what judicial interpretation says it means, and so interpreted it meets the condemnation which this court applied to the Arkansas law. It is even worse than the Arkansas legislation.

The burden upon these lands resulting from the debt created for their benefit was not the sole cause of tax delinquency. Unpaid general taxes had accumulated and were in most cases greater in amount than the assessments. The legislature probably intended to release these lands only from the accumulated liens, and give them a new start. Obviously, as soon as they went back to private owners they became liable to all general taxes which might be levied to meet governmental costs, and the existing general obligations of the municipality. The holders of the general obligation bonds then have this property as a tax source for the payment of their bonds, but the owners of the limited obligation bonds do not. Why should there be this discrimination? Are not those who furnished the funds to build water mains, sewers and sidewalks serving this particular property as much entitled to have their loans paid as those who furnished funds to build a city hall or a sewage disposal plant? If the legislature finds certain properties unable to bear their full share of governmental expense, it is decidedly unfair and oppressive to select that class of creditors who made it possible to improve the property so that it could be fit for use, and cause that class to bear the whole loss. This is not merely a measure to postpone the imposition of debt service taxes until the land can be rehabilitated; it is designed to eliminate such taxes in their entirety. It has no relationship to the purpose of correcting the cause of tax delinquency, for it

necessarily produces new delinquency. The remaining land in the assessment district, on which the owners faithfully paid their taxes, must now see their lands assessed for the deficiency caused by the newly created exempt lands. The burdens which must be imposed on them are thus made excessive, and they in turn become delinquent.

All that can be seen as a basis for this litigation, as now interpreted, is that land speculators became sufficiently powerful to have themselves put into a specially favored class, whereby they could wash out the effects of their tax delinquency and throw the burden of the cost of improving their property upon others.

CONCLUSION

Because of the foregoing, we believe that this court should conclude that the lower court erred in finding that the legislation in question is not barred by the federal constitution.

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SUPREME COURT OF THE UNITED STATES.

No. 755.—October Term, 1941.

Municipal Investors Association, Appellant, *vs.* City of Birmingham, a Municipal Corporation, et al.	Appeal from the Supreme Court of the State of Michigan.

[April 27, 1942.]

Mr. Justice Reed delivered the opinion of the Court.

This appeal challenges a decision of the Supreme Court of Michigan, which upheld the constitutionality of Michigan statutes[1] extinguishing unmatured special assessments, tax liens or other encumbrances on land sold for tax delinquency, and which therefore refused a writ of mandamus to compel the City of Birmingham to levy an additional special assessment on land so sold; to pay defaulted paving bonds issued in 1928 by its predecessor, the Village of Birmingham. 298 Mich. 314, 299 N. W. 90. The appellant, Municipal Investors Association, as holder of these bonds, claims to have a contract right under the law of Michigan in 1928 to require such an additional assessment, and asserts that the subsequent Michigan statutes construed to prevent the levy impair the obligation of its contract contrary to Article I, Section 10 of the United States Constitution.

Determination of this Court's jurisdiction of the appeal was postponed to the hearing of the case upon the merits. We think that the constitutionality of the two 1937 statutes upheld by the Michigan Supreme Court was sufficiently and seasonably drawn in question in appellant's reply, and that the jurisdictional requirements of § 237 of the Judicial Code (28 U. S. C. § 344) are satisfied. Appellant challenged the Acts as violative of the Contract Clause. But we find it unnecessary to consider the effect or validity of these statutes, for we think the appellant has failed to establish any contract right to an additional assessment after a sale to enforce an assessment lien under the preexisting Michigan law, in force when the bonds were issued.

The decision refusing mandamus for an additional assessment was entered on the pleadings. These disclose that the Village of

[1] Acts Nos. 114, 155, Mich. Pub. Acts of 1937.

Birmingham, in order to pay the cost of paving certain streets, took proceedings in 1928 to assess 23.4% of the cost to the village at large, and 76.6% to the property abutting the improvement, Special Assessment District No. 146. The property assessment was payable in five equal annual installments commencing with 1928. Of one hundred and ten parcels in District No. 146, about one hundred never paid their shares of the assessment, were offered for sale for these and other unpaid taxes at the annual tax sale of 1938, and were bid in by the State of Michigan. They were not redeemed, and were later sold by the State. About ten parcels in the District paid their shares of the paving assessment and have never been sold for taxes.

In anticipation of the collection of this special assessment the Village had issued in 1928 seventeen annually maturing serial 5¼% bonds. Of these No. 1 to No. 7 appear to have been paid, No. 8 to No. 11 were refunded, and No. 12 to No. 17, which are held by appellant, have all been in default both as to interest and principal at least since October 1, 1933. A negligible amount is on hand in the special assessment fund, and not over 20% of the amount still owing will be realized from the District's share in the proceeds of the tax sales. In order to replenish the fund, the appellant seeks to compel the defendants by the laws in force when the bonds were issued to levy upon all the land in the District, including the lots previously sold for taxes and the original assessment, an additional assessment equal to the unpaid principal and interest.

The general act under which the Village was incorporated listed among the permissible charter powers a provision "for assessing and reassessing the cost, or any portion thereof, of any public improvement to a special district;" Act No. 278, Public Acts of 1909, § 24(e); Mich Comp. Laws (1929) § 1786(e).[2] Pursuant to this authorization section 15 of Chapter XXI of the village charter provided: "Should any special assessment prove insufficient to pay for the improvement or work for which it was levied, and the expenses incident thereto, the Commission may make an additional pro rata assessment to supply the deficiency; and in case a larger amount shall have been collected than was necessary, the excess shall be refunded ratably to those by whom it was

[2] The same act stated that "No village shall have power: . . . To issue any bonds without creating a sinking fund for the payment of the same, except special assessment bonds which are a charge upon a special district created for the payment thereof, and serial bonds payable annually." Act No. 278, Public Acts of 1909, § 26(k); Mich. Comp. Laws (1929) § 1788(k).

paid.'"[3] Section 22 of Chapter XX of the charter stated that special assessment bonds should "be payable out of the special assessment district fund when the assessment is collected." In the bonds themselves the Village promised to pay the principal and interest, "said principal and interest however, being payable from the Special Assessment fund created for the purpose . . . The full faith and credit of the Village of Birmingham are hereby pledged for the punctual payment of the principal and interest of this bond from the special assessment fund created for the purpose, when the same shall have been collected."

The Michigan Supreme Court assumed, without deciding, that these various provisions did include in the bondholders' contract a right to additional assessments after a tax sale for the payment of deficiencies attributable to non-payment of valid prior assessments. 298 Mich. 314, 319, 299 N. W. 90, 92. As a contract must exist before it can be impaired, and as our conclusion against existence of the contract right settles this case, we feel it proper to consider only whether there was a contract between the bondholders and the Village for an additional assessment on the district property to meet deficiencies instead of undertaking the resolution of the constitutional issue presented by the challenged statutes of Michigan. While this approach forces us to decide the meaning of Michigan legislation without the assistance of the courts of that State, it is necessary to do so because of the obligation of this Court to determine for itself the basic assumptions upon which interpretations of the Federal Constitution rest.[4]

The complete charter of the Village is not before us. From the authorized power granted by the Public Act of 1909 under which it was organized, however, from the language in section 15 of Chapter XXI of the charter providing for "an additional pro rata assessment" and from the terms of the bond, limiting its payment to "the special assessment fund created for the purpose, when

[3] Section 18 of Chapter X of the charter of the City of Birmingham, adopted in 1933, makes provision for an additional assessment to meet insufficiencies in special assessments "for any cause, mistake or inadvertence." Section 12 of Chapter XVIII makes these provisions effective for the village debts where legally applicable. Obviously unless the village charter provision in effect when the bonds were issued authorized additional assessments to meet deficiencies, the city clause could not add that burden to the lots. It would be applicable only if it were a means of enforcing an existing right. Cf. In re Farm Drainage Dist. No. 1, Waupaca County, 232 Wis. 455, 460, 461, 287 N. W. 806, 809.

[4] Appleby v. City of New York, 271 U. S. 364, 379; Kersh Lake Dist. v. Johnson, 309 U. S. 485, 489-490; Hale v. State Board, 302 U. S. 95, 101.

the same shall have been collected," we are satisfied there was no contract to reassess lots once sold for the original assessment. If the stated powers of the Village to levy an assessment on improvement district property required that the lots assessed, after sale for default in their installments, should be subject to an additional assessment to cover such deficiencies, the burden might depress their value to a point where little if anything could be realized for the bondholders, and successful sale for non-payment would be frustrated. This would clearly be true where, as here, a very large proportion of the assessments were defaulted. A prospective investor in the bonds must look ultimately to the sale of each lot for the payment of the amount assessed against that particular parcel.[5]

Section 15 of the village charter authorizes an additional assessment when the original assessment proves insufficient to pay for the improvement. Assessment bonds may be based on undertakings whereby benefited lands may be liable even after they were sold to pay the assessment liens upon them to recover for defaults in sales of other assessed properties. See *Kadow* v. *Paul*, 274 U. S. 175. But in the absence of controlling Michigan law, section 15 repels such a construction. The language falls far short of subjecting lots which have been sold to pay tax or assessment liens to an additional assessment for the deficit. Such a construction would defeat the remedy of tax sales as a means of realizing the assessment lien.[6]

The opinion of the Supreme Court of Michigan does not deal specifically with the status of the lots which have not been sold to satisfy the assessments. In the absence of an assignment of error upon that ground, we express no opinion thereon.

Affirmed.

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[5] A general lien upon lands in a district has been held to be created by suitable statutory provisions. American Securities Co. v. Forward, 220 Cal. 566, 32 P. 2d 343.

In drainage and irrigation districts the cases differ as to whether bonds with the district as obligor are the general obligations of the district or payable only from the special assessments against each parcel.

Separate obligations: Interstate Co. v. Montezuma District, 66 Colo. 219, 181 P. 123; State v. Board of Commissioners, 89 Mont. 37, 95, 276 P. 1, 18; Nelson v. Board of Com'rs., 62 Utah 218, 218 P. 952.

General obligations: American Falls Reservoir Dist. v. Thrall, 39 Idaho 105, 124, 228 P. 236, 241; Noble v. Yancey, 116 Ore. 356, 241 P. 335; State *ex rel.* Clancy, v. Columbia Irr. Dist., 121 Wash. 79, 87, 208 P. 27, 30.

[6] Courts of other states have considered similar questions. Wilcox v. Riverview Dist., 93 Colo. 115, 25 P. 2d 172; Reinhard v. City of Caldwell, 55 Idaho 342, 42 P. 2d 292; Harte v. Truckenmiller, 228 Iowa 819, 293 N. W. 568; State *ex rel.* Johnson v. Dayton, 200 Wash. 91, 93 P. 2d 909. But cf. State *ex rel.* v. Holt, 135 Mo. 533, 37 S. W. 521; In re Farm Drainage Dist. No. 1, Waupaca County, 232 Wis. 455, 287 N. W. 806 (district was promisor).